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MANUFACTURERS HANOVER

Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

Economics Influences Politics in United Kingdom

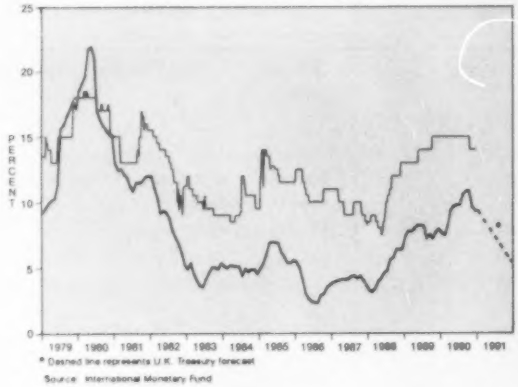
News stories around the world would lead one to believe that Margaret Thatcher's style, attitude toward Europe and implementation of an unpopular local tax last April were the principal issues that led to a rebellion within the Conservative Party and resulted in her resignation as Britain's Prime Minister. But, this tells only part of the story. Perhaps equally important were shortcomings in macroeconomic policies, especially today's high interest rate monetary policy, which has so far done little to curb inflation, yet has managed to trigger a recession.

The U.K.'s inflation rate had been rising rapidly for almost three years, reaching a lofty 10.9 percent in August, almost twice the European average. At the same time, the government's anti-inflation policy kept short-term interest rates at a punishing 15 percent for an entire year. Most likely, these developments, not to mention a winding down of the pace of business and mounting joblessness, were the major reasons why the opposition Labor Party had vaulted to such a substantial lead in most public opinion polls last summer—often as large as 20 percentage points—making Mrs. Thatcher's own party question whether she was again "electable".

When Mrs. Thatcher assumed office in 1979, her chief goals were to make the economy more productive through a series of so-called "supply-side" initiatives and to combat inflation. With a firm commitment to free markets and a disdain for socialism in any form, she slashed the economic power of the state and worked tirelessly to enhance the role of private enterprise. Wage, price, credit and exchange rate controls were abolished, efforts to tame the labor unions were intensified, close to $60 billion worth of public assets were sold to private shareholders, income tax rates were lowered and public spending cut from the equivalent of 44 percent of GNP in 1979, to 39½ percent last year.

And, for a while at least, these policy moves worked, producing a prolonged business expansion and subduing the rate of inflation. Lofty interest rates and a sharp appreciation of the pound brought the year-over-year inflation rate from a high of 22 percent in May 1980 to as low as 2½ percent in July 1986. However, it was won at a tremendous cost, as the number of workers without jobs soared above three million by mid-1986, from barely one million in 1979.

12-MONTH PERCENT CHANGE IN U.K. INFLATION (THICK) VS. U.K. BASE RATE (THIN)



* Dashed line represents U.K. Treasury forecast

Source: International Monetary Fund

Roots Of The Problem

The roots of the U.K.'s current economic woes have little to do with the structural reforms initiated by Mrs. Thatcher's government, but rather the monetary policy flip-flop which occurred in the wake of the October 1987 global stock market crash. Responding aggressively to widespread expectations of recession, interest rates were dramatically lowered, and the base (reference) rate collapsed to eight percent by early 1988, its lowest level in ten years. As a result, although the government was cutting back its own outlays, British consumers went on a spending spree, fueling an upturn in the rate of inflation and sparking a surge in imports.

With the economy threatening to overheat, the government abruptly reversed direction in early 1988. It tightened the monetary screws considerably, eventually pushing the base rate up to 15 percent by October 1989. But, despite the policy reversal, the damage had already been done. This is because lofty pay settlements had become deeply embedded within the fabric of British industry during this period, enabling consumers to maintain a high level of spending.

Notwithstanding Mrs. Thatcher's many supply-side achievements, the resurgence in inflation during the past three years began to undermine

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confidence in her economic management. With the year-over-year inflation rate back in double digits and interest rates at their highest level since 1981 (see chart), many questioned whether she was back to where she had started. And, with the economy in a recession that some think could be as severe as in 1980-81 and unemployment rising rapidly, they wondered if it was all worth it.

The Economy Will Remain An Issue

Just as both the government and private economists had underestimated the strength of the U.K. economy three years ago, they have, until very recently, underestimated its current weakness. The latest GDP, retail sales, industrial output, unemployment and money supply data confirm that the economy is in its worst shape since the 1980-81 recession.

Not surprisingly, dismal economic statistics and slumping government popularity go hand-in-hand. Over the past month there has been a sharp slide in the Conservative Party's lead in the public opinion polls, which quickly reemerged after the resignation of Mrs. Thatcher. This lead fell from eleven percentage points in November, when John Major, the new Prime Minister, assumed office, to less than five percentage points today. Thus, it appears that

Short Term Paper Outstanding
(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/12/90)	204,807	- 704	- 12,307
New York City (12/12/90)	34,945	- 344	- 6,589
Commercial Paper (12/12/90)	563,879	+ 5,379	+ 43,348

Bank Loans
(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/12/90)	317,122	- 1,698	+ 12
New York City (12/12/90)	57,397	- 919	- 2,679

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (12/12/90)	1,022,608	+ 1,892	+ 28,967
New York City (12/12/90)	179,454	+ 470	- 4,950

Financial Markets

	Friday 12/28/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	6.64%	- .14	- 1.27
180-Day Bills†	6.84	- .08	- 1.09
Longest Bills†	6.88	- .06	- .86
Recent Issues:			
7¼s 12/31/92 (When Issued)	7.24	NA	
7⅞s 2/15/96	7.80	+ .05	
8⅛s 11/15/00	8.13	+ .03	
8¼s 8/15/20	8.30	+ .02	
Municipals:			
Bond Buyer—20 Bond Index* (12/27/90)	7.14%	+ .03	+ .17
Blue List Total ($ Million)	$1,549	- $ 58	+$ 24
30-Day Visible Supply ($ Million)	$ 989	+ $738	- $ 188
Total	$2,538	+ $680	- $ 164
Corporates:			
Moody's Aa Composite (12/27/90)	9.40%	+ .01	+ .27
30-Day Visible Supply ($ Million)	–0–	–0–	- $1,910
Stocks: (Thursday, 12/27/90)			
Dow-Jones Averages:			
Industrials	2,625.50	- 3.96	- 106.80
Transportation	913.42	- 2.25	- 261.01
Utilities	210.45	+ .57	- 24.96
65 Stocks	920.41	- .93	- 109.75
N.Y.S.E. Composite Index	179.48	- .84	- 14.10
N.Y.S.E. Avg. Daily Vol. for Week (000's)	79,610	- 97,090	- 33,923

*34% Taxable equivalent 10.82%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 12/28/90	Week Ago
Overnight	9.00%	7.44%
1 month	7.50	8.75
3 month	7.44	8.13
6 month	7.44	7.63
1 year	7.44	7.56

FOREIGN EXCHANGE SPOT RATES

New York Opening (12/28/90)	Currency Per U.S. $	Week Ago
Belgium	31.06	31.60
Canada	1.1609	1.1591
France	5.1120	5.1995
Germany	1.5030	1.5295
Italy	1132.70	1154.70
Japan	135.60	136.10
Mexico	2949.40	2946.60
Netherlands	1.6950	1.7270
South Korea	703.49	703.39
Switzerland	1.2840	1.3125
Taiwan	26.64	26.64
U.K.*	1.9170	1.8759

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (12/28/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.7%	-9.5%

just as the state of the economy cost Mrs. Thatcher her job, the country's economic health will determine whether the Tory Party, itself, wins or loses the next election, which must be held by June 1992.

While Mr. Major has much to do in such previously-neglected areas as education and infrastructure, his most immediate task will be to stabilize the economy. However, now that the pound has entered the exchange rate mechanism of the European Monetary System (EMS), and the currency is obligated to trade within specific ranges, this will be easier said than done. Despite the marked weakening of the economy, sterling's current position at the bottom of the EMS currency grid makes it difficult for the Bank of England to loosen monetary policy and still hold the pound steady, especially when interest rates are rising in the other EMS member countries.

Alternatively, the sharper the recession, the faster the inflation rate will drop. If official expectations of a 5½ percent inflation rate by the end of next year materialize, the stage would then be set for lower interest rates and a resumption of economic growth, and an important determinant of British voting behavior will work in Mr. Major's favor. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 12/19/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	245.644	- 3.009	+16.261
Loans to Depository Inst.	.155	+ .032	- .033
Float	.676	+ .184	- .633
Total Reserve Bank Credit	286.508	- 2.537	+18.968
Treasury Deposits with Federal Reserve Banks	5.406	+ 1.258	+ 1.004
Currency in Circulation	282.470	+ 1.318	+25.787
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	248.971	- 1.520	+16.702
Member Bank Reserves:	**12/12/90**		
Total Reserves Held	60.183	+ .226	- .448
Excess (Deficiency)	.689	- .295	- .070
Net Free Reserves	.584	- .232	- .046

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (12/10/90)	820.4	+ 1.8	+ 4.0
M2 (12/10/90)	3,318.0	+ 0.6	+ 3.4
M3 (12/10/90)	4,087.2	- 1.1	+ 1.3
Domestic Nonfinancial Debt (3rd Q'90)	10,309.3	+ 7.0	+ 7.5

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 12/28/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	6.48%	6.57%	6.48%
* Federal Agencies	7.10	7.10	7.15
* Municipal Notes–High Grade (34% Taxable Equivalent)	7.65	7.80	7.95
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	9.10	8.20	7.55

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	8.00%	Jan.	9.20%
15- 29 days	7.50	Feb.	8.75
30- 59 days	7.30	Mar.	8.20
60- 89 days	7.30	Apr.	8.00
90-179 days	7.10	May	7.95
180-239 days	6.65	Jun.	7.60
240-270 days	6.65		

‡ Industrial Paper–Prime			
30- 89 days	8.72%	†Federal Funds Effective Rate	8.75%
90-120 days	8.15		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	3rd Q'90	$ 5,515r	$ 5,443	$ 5,239
Gross National Product (1982 Dollars)*	3rd Q'90	$ 4,170r	$ 4,155	$ 4,130
Percent Change, Annual Rate	3rd Q'90	1.4r	0.4	1.7
Change in Consumer Prices*	Nov '90n	3.6%	7.2%	3.6%
Change in MH Cost of Living Index*	Nov '90n	4.8%	3.6%	4.8%
Change in Producer Prices*	Nov '90	6.0%	13.2%	1.2%
Civilian Employment (Thousands of Persons) †	Nov '90	117,261	117,711	117,836
Unemployment as % of Civilian Labor Force †	Nov '90	5.9%	5.7%	5.3%
Personal Income*	Nov '90n	$ 4,710	$ 4,697r	$ 4,470
Leading Indicators Composite Index (1967=100) †	Nov '90n	139.7	141.4r	144.6
Industrial Production Index (1977=100) †	Nov '90	107.5	109.4	108.1
Net Change in Consumer Installment Credit †	Oct '90	$ 1.47	$ 2.84	$ 4.43
U.S. Merchandise Trade Balance †	Oct '90n	- $ 11.61	- $ 9.33r	- $ 10.15
Plant and Equipment Expenditures*	1st Q'91n	$ 557.9(a)	$ 532.8(a)r	$ 532.4
Private Housing Starts (Thousands of Units)*	Nov '90n	1,129	1,033r	1,347
New Construction Expenditures*	Oct '90	$ 434.4	$ 428.9	$ 429.3
Total Business Inventories †	Oct '90	$ 813.9	$ 810.8	$ 794.0
Total Business Sales †	Oct '90	$ 551.9	$ 547.2	$ 526.1

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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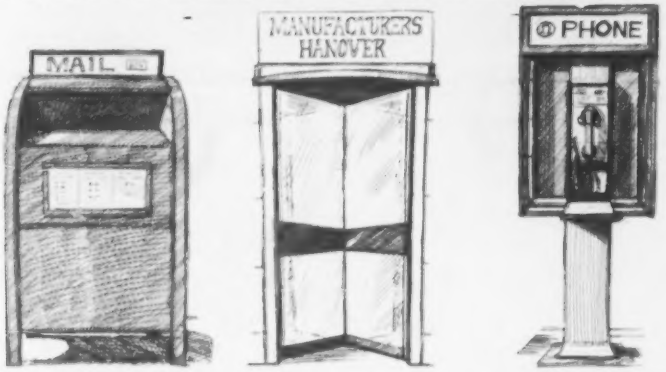

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